

# **NIGERIA**

## **JOINING THE RACE FOR NON-OIL FOREIGN INVESTMENT**

### **EXECUTIVE SUMMARY**

- i. In recent years Nigeria has come to recognize the critical role that the private sector can play in the country's economic and social development. Reflecting this, the Government has taken steps to reorient economic policy, and foster private-sector-led growth and foreign investment. Liberalization of the foreign investment regime to allow majority foreign ownership, lifting foreign exchange controls, the three-stage privatization program and the new President's major anti-corruption drive are just four examples. Reflecting the positive developments, the "Improvement and Optimism Indexes" offered by the World Economic Forum's Africa Competitiveness Report 2000-2001 rank Nigeria fourth amongst 12 African countries in terms of "improvement", and first in terms of "optimism."
- ii. Nevertheless, Nigeria remains an extremely challenging environment for private investment. Overshadowing everything else are three fundamental problems facing all businesses both foreign and domestic: weaknesses in infrastructure provision (especially power and telecommunications), a lack of personal and property security, and poor governance including pervasive corruption and an inability to enforce contracts. Without concerted and continued efforts in these areas, efforts on other fronts, however sound, will be frustrated. Reflecting such major constraints, Nigeria ranked worse than average in the World Bank's World Business Environment Survey amongst 18 African countries surveyed, and bottom or close to bottom in infrastructure, corruption and street crime. Its rank among all developing countries would look even worse. Such a poor business environment has resulted in low levels of domestic private sector investment, as well as severe underperformance in non-oil sector foreign investment.
- iii. Inflows of foreign direct investment (FDI) have been declining in recent years, and as a percentage of GDP (2.5 per cent in 1998) are very low for oil-rich economies. Historically, the bulk of non-oil foreign investment (perhaps 30 per cent of the total) has gone into manufacturing, especially food, beverages, textiles, chemicals and cement, although little in recent years in the form of greenfield FDI. Recently, the proportion of service sector FDI, including finance, information technology and communications has increased, helped by the potentially large domestic market, and improvements in intellectual property rights (IPR) enforcement.
- iv. To improve its business environment for domestic and foreign investors alike, Nigeria must improve its administrative procedures, laws and regulations.

Counterproductive red tape and the corruption it facilitates must be eliminated. The remaining, necessary regulatory procedures, and the institutions that enforce them, must be streamlined and made less unfriendly to private companies. These are essential complements to addressing the key constraints in infrastructure (especially telecoms and power), governance and security, and to improving the country's educational performance. There are no incentives on earth that will bring a significant amount of non-oil FDI to the country as these things now function.

v. The interaction between federal and state governments is also a pervasive issue in Nigeria's business environment. Certainly, Nigeria must continue its efforts at the federal level to improve legislation, remove administrative barriers and strengthen institutional mechanisms, but the current lack of attention to subnational issues needs to be corrected. Sometimes this is a case of conflicting federal and subnational legislation, or additional and unnecessary administrative procedures. On a more constructive note, a country of the size and complexity of Nigeria needs to foster bottom-up initiative and meaningful linkages across the different levels of government.

### **Legal, Policy and Administrative Issues**

vi. *Legal and policy issues.* Most of the important laws are of good quality. However, there are a variety of problems, partly due to the legal legacy of the long period of military rule, that need to be addressed. These include outdated, conflicting or overlapping legislation, as well as shortcomings in the administrative implementation of laws, and in the capacity of the judicial system to enforce them. Sometimes the problem lies with the legal environment at the federal level, in which case the solution may be to strengthen some laws, and resolve conflicts in other laws and regulations (e.g. immigration and intellectual property laws), or to clarify the various procedures at the implementation level (e.g. customs regulations). Often, however, other levels of government (state and local) are also involved, and there is a need to resolve conflicts across levels of government (e.g. land, tax administration, incentive provision and company registration).

vii. *Procedural and administrative issues.* Investors in Nigeria face a variety of administrative barriers to investment that can be grouped under four headings: entry, locating, reporting and operating. Both foreign and local firms find the government to be their enemy. Mid-level and front line civil servants tend to be unresponsive, poorly-trained, unwilling to take responsibility or make decisions, slow to process routine applications, and often to be looking for bribes. Investors report that Nigerian government agencies regularly and arbitrarily intrude upon normal decision making processes and often seek excessive explanation or clarification to issue routine approvals.

viii. The *judicial system* has proven extremely bad at processing cases or enforcing decisions. Courts are slow, inefficient and corruptible. Problems include inadequate funding, poor physical facilities, staff shortages and congestion, inadequate training, and corruption. The enforcement of commercial contracts continues to be a primary concern for investors, and acts as a significant brake on domestic and foreign private sector activity. Finally, although Nigeria has arbitration legislation, there appears to be a

reluctance, especially at the subnational level, to utilize the legislation's provisions or enforce arbitration decisions.

ix. *Intellectual property rights (IPRs) and trademark laws* are one area where Nigeria can boast of recent progress despite great historical weakness. The pharmaceutical and software industries, in particular, have been beneficiaries of improved performance in this area, and leading software companies have stepped up their commitments.

x. *Labour and immigration legislation, and "entry" procedures.* Labour and immigration legislation offers examples of conflict with regard to the issuance of expatriate employment quotas, and of the need for clarification / updating of the rules about aspects such as employee termination and allowing piece-rate remuneration.

xi. Procedures governing the issue of visas, employment permits and expatriate employment quotas for foreign investors are complicated, time-consuming and involve several different poorly-coordinated agencies. The Government should reduce the number of different visas issued, and standardize the review procedures and submission requirements, thereby easing bureaucratic workloads and giving potential investors greater flexibility. Certain types of visa for nationals of some countries (e.g. potential investors or trading partners) should be available at ports of entry. The requirement of invitation letters for various visas should be abolished,.

xii. *Regulations and procedures involving multiple levels of government.* Company registration, land legislation and tax / incentive legislation and procedures share the characteristic of involving multiple levels of government (federal, state and municipal). From a business perspective, this confusion and opacity raises the costs and risks of investment and business operation.

xiii. *Company registration rules and procedures.* Company registration involves multiple levels of government, and is overly burdensome. Currently, a foreign investor must register his company in at least three different places: with the Corporate Affairs Commission (CAC) under the Companies and Allied Matters (CIMA) Act; with the Nigerian Investment Promotion Commission (NIPC) under the NIPC Act; and at the state level also. Registration should be greatly simplified becoming the responsibility of CAC, with other agencies automatically recognizing its endorsement, and CAC sharing the relevant information. CAC's processing times should be reduced from the current one to three months to a matter of days. NIPC's submission requirements, including proof of land ownership and importation of capital goods are excessive, and should be removed.

xiv. *Taxation system.* Nigeria's taxation system is extremely confusing with all three levels of government raising a variety of taxes and levies. In addition to the normal federally-levied taxes, at the subnational level there are also many similar taxes, and a variety of more "opportunistic" and unpredictable ones. While the administration of the Federal Inland Revenue Service is relatively efficient, enforcement procedures at sub-national levels are too often arbitrary and corrupt. Minor disputes can lead to businesses having their operations suspended.

xv. The whole tax structure is poor, with few companies actually paying taxes (amongst them listed and foreign companies), and enforcement capacity weak. The playing field needs to be levelled. The practices of arbitrary taxation and closing down businesses during tax disputes, in particular, need to be stopped if Nigeria is to create a positive and stable investment climate.

xvi. A thorough-going reform of Nigeria's business taxation system is desirable, with a view to streamlining it, for example through reducing the number of individual tax payments required. As part of the streamlining process Nigeria could also work towards creating a shared application form for CAC, NIPC, corporate tax, VAT and state business license registration. The objective should be the kind of low rate, broad-based system with few or no exemptions, which many countries are successfully moving to. Finally, the issue of adequately funding state and local budgets needs to be addressed, including a review of Nigeria's federal budgeting mechanism in order to devise a practical approach to collecting and distributing government revenue.

xvii. *Incentive system.* The Nigerian government, notably at the federal and state level, offers a variety of investment incentives to foreign and domestic investors, but its complexity means that take-up, especially of fiscal incentives, is minimal. There appear to be four general types, most usefully grouped by the mechanism for their award or administration: a) exporter grants and duty drawback schemes (i.e. the Manufacturing in Bond scheme); b) pioneer-status tax holiday for a variety of industries; c) other formal tax exemptions and incentives contained in the Companies and Allied Matters Act, the Companies Income Tax Act (CITA) and other legislation; and d) negotiated tax incentives at both the federal and state levels. The confusion is compounded by a number of factors: award criteria are often unclear; many incentives appear to overlap; many are poorly defined; many are awarded in a discretionary manner late in the investment process; and it is sometimes unclear who actually awards them. Consequently, their effectiveness is doubtful, leading to the apparently low take-up rate. Tax holidays, in particular, are generally ineffective and inefficient, affecting the decisions of only a rather small percentage of foreign investors, and being expensive in terms of cost incurred and revenues foregone. With a well-designed system most if not all of the incentives could be eliminated. The procedures for obtaining any incentives the Government of Nigeria decides to keep should be made crystal clear and automatic.

xviii. *Land acquisition and construction regulations, and "locating" issues.* Land and construction-related legislation is also confusing and excessively severe. Nigeria should clarify and improve the process of land acquisition both in federal legislation, and in its subnational implementation. One of the key problems is the provision in the Federal Land Use Act that vests the power to approve all urban land transfers and mortgage applications (which must be done separately) in state governors. The existence of several different types of land and occupancy only adds to the complications of acquiring land. Gubernatorial approval and multiple negotiations can take many years, and a much simplified system needs to be introduced, at the very least for more productive urban land. The resolution of land ownership disputes is similarly convoluted. The various

land-related laws need to be reconciled, and the excessive power vested in state governors curbed.

xix. Guidelines covering land acquisition and registration procedures should be compiled for the reference of all affected parties, an effort in which NIPC (together with the Nigerian bar association) could play an important role. Subnational initiatives to simplify the process, such as improved land recording systems and transferable land rights especially in areas suitable for commercial activity, might also be useful.

xx. Construction approvals and procedures in Nigeria are essentially the preserve of state and local governments, and the process can apparently take a long four to six months even without complications. Building plans, once approved by the state or local planning commission, must also be submitted to the Ministry of Commerce for approval. Clearly the construction approval process needs to be simplified, including the elimination of any duplicate approvals. The quality and transparency of the various inspection procedures (e.g. building, environmental, fire) also need to be assessed in a more detailed study of “locating” procedures.

xxi. *Customs legislation and procedures.* A new Customs Code is currently being prepared, and this should seek to rationalize, bind and reduce rates of nominal protection, as well as clarify procedural matters. Although the law needs reforming, it is above all the extremely poor implementation of regulations and institutionalized corruption that is the biggest problem for foreign and domestic business alike. Customs procedures and their enforcement are one of the worst aspects of government regulation in Nigeria. False invoicing, counterfeit documentation, extortion, fraud, unclear security arrangements, predatory inspections and other hazards increase the costs of imports by an estimated 45 per cent.

xxii. Urgent streamlining of Nigeria’s customs system is clearly necessary. Bottlenecks need to be identified, and overlapping and conflicting procedures resolved, possibly guided by successful examples elsewhere in Africa. Pre-shipment inspections either need to be replaced by random inspections, or their valuations respected, and egregious behaviour severely punished, as Crown Agents (who have taken over customs procedures in Mozambique) are doing. A clear guide to the entire import and export process should be published, and particular attention paid to eliminating opportunities for corruption. The shortcomings of the customs environment are compounded by very poor port infrastructure.

xxiii. Nigeria’s duty drawback scheme needs to be decentralized with claimants being allowed to submit documentation at the port of entry rather than in the inland capital, Abuja. Finally, a review should be conducted of how the Standards Organization of Nigeria (SON), the National Agency for Food and Drug Administration and Control (NAFCAD) and the Federal Environmental Protection Agency (FEPA) enforce Nigeria’s health, safety, and environmental standards.

### **Institutional Issues, NIPC and Promotion Strategies**

xxiv. In order to improve the environment for foreign investment in Nigeria, many of the government institutions involved in the investment process need to be reoriented, whilst other new mechanisms need to be established. As things stand, government agencies appear to communicate poorly with one another, and with the private sector, and to persist with a model of bureaucratic control often involving useless and indeed counter-productive monitoring and screening functions. Also, problems of overstaffing, lack of competence and low morale at government agencies must be addressed.

xxv. Recognizing some of barriers facing investors in Nigeria, the government took the step of establishing, and recently putting additional resources into the Nigerian Investment Promotion Commission (NIPC). Under its “one-stop shop” mandate NIPC aims to provide prospective (especially foreign) investors with all the permits, licenses and support needed to undertake an investment in Nigeria, but this is not a feasible objective. Although it is also (formally) charged with promoting and facilitating foreign investment, and advising the government on policy issues, NIPC appears preoccupied with its control and screening functions.

xxvi. The service mandate of NIPC is perfectly appropriate, but a true “one stop shop” is not a feasible objective. NIPC should not be in the business of issuing permits or licenses, or monitoring the compliance of investments. Rather it should be assisting investors to complete whatever procedures are necessary to begin operations as quickly as possible. The NIPC business permit should be eliminated. NIPC should have two overriding goals at the current stage in its development:

- To become an effective investor-service organization with more modest, but more achievable goals than becoming a one-stop shop.
- To champion improvements in the investment climate in Nigeria.

xxvii. The two goals are closely linked since an agency that properly services the investor – helping him negotiate the various procedures – learns the details of those procedures and the various institutional weaknesses, and is uniquely equipped to lead a prioritised effort to reform them. Bolstered by high level political support NIPC can play a pioneer role. Image-building and targeted investment generation activities should be de-emphasized at this stage.

xxviii. Currently NIPC officials do not have the skills, knowledge or relationships to pursue these twin objectives effectively. They need to be strengthened in many ways:

- Better knowledge of the basic facts about NIPC and its operational mandate; about what investors are required to do or submit to NIPC and elsewhere in the investment process; and about the incentives available to investors and the locus of authority over them;
- Build better contacts with other agencies and existing investors;
- Change the incentive structure for NIPC employees through reformed personnel policies (e.g. hiring, pay and dismissal rules); and

- Acquire greater skills in investment servicing and facilitation through a complementary process of hiring qualified staff and training the best of existing staff.

xxix. Three other aspects of promoting FDI should also be addressed:

- Nigeria's federal system opens special possibilities (and problems) for promoting foreign investment. Given the country's size and complexity, active efforts to reform the investment environment and promote investment at the subnational level are essential. State or local initiatives, some of which are taking place in several states, can accelerate reform and result in more investment for the country as a whole.
- There are various "zone" strategies that could provide places to experiment with new policies and simplified procedures, help foster clusters of similar or complementary supporting industries, and offer superior transport, energy and telecom infrastructure. The existing federal EPZ strategy should be revisited in light of its limited success to date.
- In prioritizing reforms, the authorities could focus to some extent on several promising sectors – giving higher priority to fixing the obstacles to growth in those sectors. This is emphatically not a case of picking winners, but of focusing scarce political and human resources for reform where the market is showing it will do the most good. Although most non-oil FDI that might come to Nigeria will target the local market, some export-oriented investment potential also exists. Thus, in addition to crucial reforms targeted at financial and infrastructure services, other potential sectors (some with export potential) include textiles and garments, agriculture and agroprocessing, as well as information technology and some other high tech sectors.

## EXECUTIVE SUMMARY OF RECOMMENDATIONS

### **Enforcement of Laws and the Judicial System**

**Nigeria recognizes the need to address the many shortcomings in its judicial system.** Particularly where the laws themselves are in place, the training of judges and other officials is crucial. Task forces combining some of the nation's high-quality lawyers and judges, and a number of international experts, could be created to plan and implement this work.

**Potential foci for legal review efforts could be land and construction, taxes and incentives, and inspections and contracts.** Although most aspects of the legal system affecting foreign and domestic investors need to be reviewed in varying degrees, this would be an enormous task, and there is a clear need to prioritize legal reform and training efforts. Legislative reform efforts and associated task forces should pay particular attention to outdated and conflicting legislation, especially where there are overlaps between different levels of government.

### **Intellectual Property Rights (IPRs)**

**Nigeria must ensure far stricter implementation and enforcement of the legislation in order to attract foreign investment and foster growth amongst its own entrepreneurs.** Above and beyond the clear Presidential commitment to IPR enforcement and the rising number of successful IPR prosecutions in Nigerian courts, much remains to be done. In particular, the benefits of better enforcement must be made accessible to all, since, for example, protracted prosecutions are not practical for smaller companies whether domestic or foreign.

### **Taxation**

**Nigeria's priority should be to review and simplify the taxation and incentive system across the various levels of government (federal, state, municipal).** The corporate income tax should be reformed, with the objective of a slightly lower rate (30 percent is not unreasonable but it could perhaps be a bit lower) together with a broader base and few if any incentives. The current incentive system is non-functional: it is ineffective in attracting investments and facilitates bribery and unequal treatment. The playing field needs to be leveled. Every incentive now available should be critically reviewed as part of the tax reform. Most should be eliminated and any remaining incentives should be automatic.

**Tax reforms should also include a better system for redistribution of revenues to state and municipal governments.** Among other benefits, a better system should reduce the pressure on states to introduce arbitrary taxes (to make up revenue shortfalls), and so lead to a more stable investment climate.

**Tax collection should be the sole responsibility of government tax authorities. The use of others, including the military or private agents, should be abolished.** Legislation governing the authority of tax officials to halt production should be reviewed; this process is unusual internationally and subject to much abuse.

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### **Taxation (continued)**

**The power of state and local authorities to assess taxes and other fees on businesses needs to be curtailed.** Nigerian legislation should be revised to circumscribe the authority that state and local governments have in creating new taxes and also set limits on how often new levies can be imposed.

The government might consider introducing a single shared application form and process could combine CAC, NIPC, corporate tax, VAT, and state business license registration processes into a single endeavor.

The provisional tax payment requirement should be dropped since few companies pay it anyway, and it is not enforced.

### **Employing**

**Procedures governing the employment of expatriate labor should be streamlined.**

Currently, the employment of expatriate labor by foreign investors seems to be subject to both expatriate quota approval and work permit applications. Ideally, expatriate employees should only need to get work permits with the approval process handled by the Department of Immigration (as it is now). Response times should be substantially improved, and the chief immigration officer's involvement only required in exceptional circumstances. If the expatriate quota system is to be retained, the process should be made automatic.

**The number of different visas issued should be reduced, and the review procedures / submission requirements should be simplified and standardized.** Some visas should also be available at airports upon arrival. The requirement for an invitation letter should be abolished.

**Nigeria's labor laws should be reviewed to ensure that they are consistent amongst themselves, and conform to international norms, especially in the light of the African Growth and Opportunities Act conditions.** The areas of termination benefits, ease of dismissal, and dispute resolution bear particular attention. A "piece rate" compensation option could be permitted where both parties agree.

### **Locating**

**The Nigerian government should make a concerted effort to reconcile the various land laws at the federal and subnational levels as part of a larger effort to modernize the system of land transfers.** A much simplified system is needed, at the very least for more productive urban land.

**The almost unrestricted power of state governors to approve land transfers should be abolished, and replaced by a transparent and procedurally fair system.** A detailed analysis should be conducted to clarify which bodies are involved in land acquisition and registration. The responsibility for each step should be clarified, and a publicly available guide explaining procedures, fees, approval criteria and timeframes should be prepared. Performance measurement systems should be instituted.

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### **Locating (continued)**

**Considerable improvement is also needed in the area of construction legislation and building permit procedures.**

- Some of the severer provisions of the Factories Act need to be reviewed. Formally, at least, the Factories Act requires a prospective investor to submit building plans to the Director of Factories six months prior to commencing construction, with failure to comply subject to criminal prosecution. Such requirements and punishments are clearly excessive.
- Response times for building permit applications should be improved, based upon a detailed assessment of procedures of the agencies and departments are involved, and the bottlenecks encountered by investors.
- The quality of the various inspections needs to be improved, with bribe-seeking amongst inspectors curbed by better enforcement, better pay and training for officials, and published criteria for inspections that are clear and unambiguous.

### **Reporting**

**Registration at the federal level should be the sole responsibility of CAC.** The regulations and procedures for company registration for foreign investors in particular are duplicative and counterproductive. The information should then be shared internally within the government structure with NIPC, the Statistical Office, and so on. CAC should identify and remove bottlenecks so as to reduce its processing time from the current 1-3 months to international best practice of a few days.

- Individual states should limit registration to transcribing and accepting the details already solicited by CAC.
- The separate NIPC registration should be abolished, and NIPC should cease to monitor start-ups.
- The CAC requirement that a firm demonstrate proof of having deposited capital in a local bank should be abolished. Companies that wish to register their capital with a local bank may continue to do so.

### **Operating**

**Combating corruption in Nigeria's customs system is an enormous but essential task.** Elements of this task include streamlining and publicizing goods clearance procedures; eliminating procedures that have little purpose other than to provide opportunities for corruption; clarifying the powers of, and relationships between, the various inspection officials operating at Nigeria's ports; and building better fraud inspection capabilities, with guilty parties seriously and visibly prosecuted.

**Urgent streamlining of Nigeria's customs clearance system is required.** Once further investigation has identified the procedures and bottlenecks involved, a clear guide should be published. Customs officials also need training in clearance procedures and dispute resolution.

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### **Operating (continued)**

**If pre-shipment inspections are to be continued, their valuations should be respected without undue conflict.** Most countries rely on random inspections to ferret out fraudulent activity and smuggling. A properly designed and implemented random inspection regime would allow customs officials to inspect only a small proportion of goods, reduce customs delays, save officials' time, and deter fraud.

**Nigeria's duty drawback scheme should be decentralized, with claimants being allowed to submit documentation at the port of entry.** In its current form, the process can take up to one year, and apparently requires the claimant to visit Abuja to file the requisite documents with the Nigerian Export Promotion Council.

**Nigeria should increase opportunities for private participation in improving the quality of port and other logistical infrastructure.** Various options for encouraging private investment in Nigeria's inefficient ports should be explored, including Build-Own-Operate/Build-Own-Transfer schemes, management contracts, and so on.

**A review should be conducted of how SON, NAFDAC and FEPA enforce Nigeria's health, safety, and environmental standards.**

### **Government-Private Sector Relations**

**The national and state economic summit processes should be broadened and deepened.** Political leadership at each level should endorse this and other processes of public-private interaction, and facilitate working level mechanisms to encourage reform.

**The Government of Nigeria should continue to promote the West Africa Enterprise Network** to both facilitate the adoption of best practices among west African nations, and to facilitate the emergence of a new generation of business leadership.

### **Nigerian Investment Promotion Commission (NIPC)**

**The government should reform the objectives, strategy and structure of the Nigerian Investment Promotion Commission (NIPC).** Investment promotion will be ineffective / counterproductive unless the business and investment environment is improved substantially.

**NIPC should focus on two activities: assisting actual and potential investors in Nigeria, and identifying and advocating the most necessary policy reforms.** The mandate to be a "one-stop-shop" is infeasible and should be dropped, as should the licensing and monitoring functions.

**NIPC must strengthen or reactivate relationships with existing foreign investors.** This helps build knowledge of procedural and negotiating precedents, and allows NIPC officials to address impediments to expansion or reinvestment by those companies. Existing investors can be either a country's best ambassadors or worst detractors. Building relationships with these companies, and an informational database on them, is fundamental.

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### **Nigerian Investment Promotion Commission (continued)**

**In its servicing function, NIPC should begin work earlier, with potential investors.**

The practice of limiting assistance to investors who have already registered with the CAC should be dropped; effective pre-investment-decision services are key to promotion.

**Drop the NIPC Business Permit**, which serves no useful purpose.

**Move to a “lean and mean” staff.** The number of personnel (more than 200) that the NIPC has in its Abuja office far exceeds what is needed to carry out the activities that it should undertake in the immediate future. The agency needs to move to a smaller number of well-qualified and trained staff who are able to understand both investor and government perspectives. Overseas offices are not needed until the country’s business climate is considerably improved.

### **Subnational Dimensions of Investment Promotion**

**Some part of the government, perhaps NIPC, should lead an analysis of what federal level regulations, procedures and institutions compromise the efforts of states to attract investment.** Such impediments should be removed to the extent possible.

**The current federal export processing zone strategy should be revisited in light of its limited success to date, and other kinds of “zone” strategy should be investigated.**

International experience shows that different kinds of zones can be useful as places to experiment with new policies and simplified procedures, help foster clusters of similar or supporting industries; to provide superior telecoms, power, and/or transport services, etc.